CFA Consumer Federation of America

Testimony of
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Consumer Federation of America

"Financial Services Issues: A Consumer's Perspective"

On Behalf of the Consumer Federation of America, National Consumer Law Center,
Center for Responsible Lending,
Consumers Union and the U.S. Public Interest Research Group

Before the House Committee on Financial Services
Subcommittee on Financial Institutions and Consumer Credit

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Chairman Bachus, Ranking Member Sanders, and Members of the Committee, my name is Jean Ann Fox and I am the director of consumer protection for the Consumer Federation of America.[1] We appreciate the opportunity to offer our comments on financial services from a consumer perspective. My testimony will concentrate on emerging credit and debit products and their impact on consumers. This testimony is also being delivered on behalf of other national consumer organizations, Consumers Union,[2] the Center for Responsible Lending,[3] the National Consumer Law Center[4], and the U.S. Public Interest Research Group[5].

Quick Cash Credit Products Cost Vulnerable Consumers Billions of Dollars

In less than a decade, the quick cash credit market has become big business, costing financially vulnerable consumers billions in triple digit interest rates and fees. Excluding credit cards and cash advances on credit cards, new and risky methods of borrowing a few hundred dollars for a few weeks have become as widespread as they are controversial. These new products include payday loans, bounce loans which banks call "courtesy overdraft" programs, and tax refund loans. These three products target cash strapped consumers who have trouble

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1 The **Consumer Federation of America** is a nonprofit association of over 280 pro-consumer groups, with a combined membership of 50 million people. CFA was founded in 1968 to advance consumers' interests through advocacy and education.

2 **Consumers Union** is the nonprofit publisher of Consumer Reports magazine. Consumers Union was created to provide consumers with information, education and counsel about goods, services, health, and personal finance; and to initiate and cooperate with individual and group efforts to maintain and enhance the quality of life for consumers. Consumers Union's income is solely derived from the sale of Consumer Reports, its other publications and from noncommercial contributions, grants and fees. Consumers Union's publications carry no advertising and receive no commercial support.

3 **The Center for Responsible Lending** is a nonprofit, nonpartisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL (www.responsiblelending.org) is affiliated with the Center for Community Self-Help, one of the nation's largest community development financial institutions.

4 The **National Consumer Law Center** is a nonprofit organization specializing in consumer issues on behalf of low-income people. We work with thousands of legal services, government and private attorneys, as well as community groups and organizations, from all states who represent low-income and elderly individuals on consumer issues. As a result of our daily contact with these advocates, we have seen examples of predatory practices against low-income people in almost every state in the union. It is from this vantage point – many years of dealing with the abusive transactions thrust upon the less sophisticated and less powerful in our communities – that we supply these comments. We have led the effort to ensure that electronic transactions subject to both federal and state laws provide an appropriate level of consumer protections. We publish and annually supplement fifteen practice treatises which describe the law currently applicable to all types of consumer transactions.

5 The **U.S. Public Interest Research Group** is the national lobbying office for state PIRGs, which are non-profit, non-partisan consumer advocacy groups with half a million citizen members around the country.

making ends meet between paydays. Borrowers pay triple digit interest rates for money that must be repaid in full on the borrower's next payday, or when the tax refund is deposited in two weeks or less by the IRS. Consumers can also spend a lot of money very fast on the array of new plastic payment cards that are being offered, such as payroll cards and pre-paid debit cards. Unfortunately, federal requirements regarding disclosures, error resolution procedures, and liability limits for credit and debit products have not been updated to explicitly cover these types of products.

We urge Congress to take action to protect consumers, specifically:

- Stop the FDIC from allowing banks to enable payday lenders in evading state usury laws;
- Stop regulatory agencies from interfering with states' authority to regulate financial markets and protect consumers;
- Harmonize payment card protections upwards to cover emerging forms of electronic payment methods, such as requiring that FDIC insurance cover funds in payroll card accounts, setting liability limits and establishing error resolution procedures to protect consumers when cards are lost or stolen or mistakes occur in card use.
- Make all lenders comply with Truth in Lending Act disclosures and protections.

Consumers Enticed to Pay Billions to Write Checks Without Money in the Bank

Consumers pay a stiff penalty for inadvertently or deliberately overdrawing their bank accounts. A growing number of financial institutions now encourage their account holders to spend money they don't have by overdrawing their accounts, in order to collect more penalty fees. Checking account service fees are up thirty-four percent in the last three years, which is the same time span for the rapid adoption of bounce loan programs at financial institutions. Financial institutions last year collected approximately $11.7 billion in insufficient fund (NSF) and overdraft fees from individual consumers who overdrew personal bank accounts. Many banks use reverse order check clearing to increase the number of checks that bounce, package "free checking" with low balance requirements and "courtesy overdraft," and advertise that accountholders can overdraw their accounts when they run short at the end of the month. In addition, consumers paid payday lenders $6 billion in finance charges for loans based on checks for insufficient funds. This approximate $17.7 billion overdraft price tag does not include the penalty fees consumers pay merchants when their checks fail to clear the bank or interest and fees paid for refund anticipation loans, rent to own, and other high-priced financial services targeted to cash and credit-constrained consumers.[6]

Emerging High-Cost Credit Products Cloak their Identity to Avoid Protections

A troubling characteristic of many of these credit products is that lenders camouflage them as something other than a loan. Creditors do this so that they can avoid quoting the products' true price and evade consumer protections required with these loans. For example,

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[6] FDIC Statistics on Depository Institutions, year to date June 30, 2004 Service Charges on Deposit Accounts $16,245,742,000 times two for annual total of $32.5 billion. Consultants estimate that NSF and OD fees make up conservatively 60 percent of total service charges and that individuals write about 60 percent of returned items.

payday lenders describe their loans as "deferred presentment." Banks call their overdraft line of credit loans "courtesy overdraft," or "bounce protection." Tax preparers tout "rapid refunds." Rent-to-own stores claim their customers are leasing appliances and furniture, not buying them on installment sales contracts. Purveyors of extremely expensive credit products are trying to avoid having to comply with Truth in Lending and other credit laws meant to protect and inform consumers and intended to provide a competitive marketplace for credit.

Fringe Financial Products Impact Vulnerable Consumers

Customers of quick cash lenders are disproportionately low and moderate income, minorities and credit-impaired families with little clout in the marketplace. Commercial tax preparers that sell high-cost refund loans cluster in working class communities. A study by the Woodstock Institute found that payday loan outlets are twice as likely to be located in predominantly African-American communities as in predominantly White communities. A drive around any military base will find clusters of payday loan outlets, rent to own stores, buy-here-pay-here used car lots, and other high-cost lenders. Banks now target low-margin consumers by marketing "Free Checking" in combination with "courtesy overdraft" loans, knowing that enough of them will overdraw their accounts to rack up high-fee income. Consumers already struggling to make ends meet are those most likely to pay the price.

Fringe Lenders Use Banks to Undercut State Usury Laws

Payday lenders who want to do business in states that have criminal or civil usury laws on the books, such as New York and North Carolina, partner with banks located in lax regulatory states, such as Delaware and South Dakota, and claim the right to make loans the non-bank lenders cannot legally make on their own. Only the FDIC now permits its banks to aid in this evasion of state consumer protections.

Some commercial tax preparers that peddle high cost tax refund anticipation loans also partner with a handful of banks located in states that do not cap interest rates. Low-wage workers are paying triple-digit interest rates for these loans (of less than two weeks in duration) just to get money faster than the IRS will deliver. Tax preparers could not make these loans at rates that far exceed many state interest laws without a bank involved.

Consumer Protections Are Not Keeping up with the Proliferation of Plastic Payment Cards

Another development that we urge this Subcommittee to examine is the proliferation of new forms of plastic payment devices and payroll delivery methods, including payroll cards and pre-paid debit cards. These new forms of payment fall through the legal protections provided for credit and debit cards and run the risk of isolating unbanked consumers in substandard financial products. It is unclear to what extent federal deposit insurance applies to pooled accounts used for payroll cards or under what circumstances the Electronic Funds Transfer Act covers prepaid debit cards. This means that consumers do not have the right to dispute erroneous transactions and have the amount in dispute restored to their account while the financial institution investigates, and do not have the right to get clear disclosures or account statements.

These new card products do not bring the unbanked into the mainstream but do come with hefty fees for users. The Federal Reserve Bank of New York reports a wide range of multiple fees that come with stored value cards. These costs of using plastic instead of a bank account can run as high as $39.95 to activate a card, up to $99.95 in annual fees, monthly fees as high as $9.95 per month, $2 for every time the card is used to buy something, and up to $2.50 to use an in-network ATM. Additional fees cover everything from overdrafts to speaking to a live person.[7]

I. Unsafe and Unsound Credit Products for Cash-Strapped Consumers

A. Payday Loans: Quick Cash for Cold Checks

Payday loans are small loans made to cash-strapped consumers, secured by a post-dated check or access to the borrower's bank account. Loans for up to $500 plus a finance charge of $15 to $30 per $100 borrowed are due in full on the borrower's next payday. Payday loans are made without regard for the borrower's ability to repay. The cost of payday loans averages 470 percent APR, far in excess of some state usury or small loan laws.

The Payday Loan Industry

The payday loan industry is made up of stand alone payday loan shops, such as Advance America, Check'n Go, and Check Into Cash; check cashing outlets that also make payday loans, such as ACE America's Cash Express and the Dollar Financial Group chain of check cashers; pawn shops, such as QC Financial and EZPawn; and companies that market payday loans via toll free phone lines and over the Internet.

Some lenders use thinly-veiled retail transactions to make payday loans that exceed state limits. Internet rebate plans and rebates with phone card sales are sometimes employed to evade consumer protections. The Indiana Department of Financial Institutions ruled that Internet rebate plans were illegal payday loans. Georgia's regulators issued a cease and desist order against a payday lender using phone cards to cloak illegal lending. Regulators in North Carolina, Kansas, and Arkansas have brought cases against sham lenders claiming to offer rebates with Internet access plans.

Industry analysts report that payday loan outlets now make $40 billion in loans a year at a cost to borrowers of $6 billion in loan fees. Growth in industry size is fed by additional states authorizing payday lending, expansion of lending into states through rent-a-bank arrangements and other devices, as well as repeat borrowing by current customers on a debt treadmill.

State Regulation of Payday Lending

Fifteen states prohibit payday lending through operation of usury or small loan laws and a growing number of states prohibit retailers from brokering loans for out-of-state banks. Alaska

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[7] Federal Reserve Bank of New York, "Stored Value Cards: An Alternative for the Unbanked?" July 2004, available at www.newyorkfed.org/regional/stored_value_cards.html

enacted payday loan authorizing legislation that will take effect in 2005. Currently 33 states and the District of Columbia grant safe harbor for check-based loans with laws or regulations that carve out payday lending from usury and small loan laws. Two more states set no usury limits for small loans by licensed lenders.

Payday Loans Trap Vulnerable Consumers in a Cycle of Repeat Loans

Payday lenders encourage cash-strapped bank account holders to write checks without funds on deposit and then use those checks to coerce repeat transactions or collections. The combination of relatively large loan size, expensive finance charges, short loan terms, and check holding results in loan flipping that traps many vulnerable consumers in perpetual debt. A report issued by the Center for Responsible Lending estimated that 91 percent of all payday loans are made to borrowers with five or more payday loans per year and nearly one in three customers receive twelve or more loans per year.[8] Iowa regulators report that the average customer in 2003 had 12.31 loans at the same lender and almost 50 percent of customers had 12 or more loans in 2003 at the same lender.[9] Information supplied by Advance America in its IPO filing at the SEC revealed that its customers average over ten loans per year.

Rent-a-Bank Payday Lending

A handful of banks have chosen to "rent" their bank powers to pawn shops and small loan companies to assist those non-bank companies to make small loans at costs that would violate state laws. Under a "rent-a-charter" arrangement, the payday lender markets the loans, solicits borrowers, accepts applications, disburses loan proceeds, and services and collects the loans. The bank generally takes only a small percentage of the loan revenues – often as little as 5 percent -- while it's so-called "agent" takes the vast majority of the revenues generated by the loan.

Ten state-chartered FDIC-supervised banks partner with pawn chains, check cashers, and payday lenders, according to CFA's latest report, Unsafe and Unsound: Payday Lenders Hide Behind FDIC Bank Charters to Peddle Usury. Payday loan banks include: County Bank of Rehoboth Beach, DE; First Bank of Delaware; BankWest, Inc., SD; First Fidelity Bank, SD: Community State Bank, SD; American Bank & Trust, SD: Bryant State Bank, SD: Reliabank Dakota, SD: Republic Bank & Trust, KY; and Venture Bank, WA.

Eleven of the thirteen largest payday loan chains use bank partners in states with consumer protection laws that do not permit unregulated payday lending, such as Pennsylvania, Arkansas, New York, North Carolina, Michigan, and Texas. Georgia recently enacted a law strengthening its enforcement tools to prevent usury and to prohibit rent-a-bank payday lending where the local storefront gets the majority of the money.

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[8] Center for Responsible Lending, "Quantifying the Economic Cost of Predatory Payday Lending," Dec. 18, 2003, p.2.

[9] Iowa DD Exam-Survey History, received Feb. 8, 2004, on file with author.

No federally-chartered financial institutions or state member banks partner with payday lenders, following regulatory action by the Comptroller of the Currency, Office of Thrift Supervision, and Federal Reserve. These regulators found that payday lending exposes federally-insured banks to unacceptable safety and soundness risks, undermines consumer protections, and carries serious reputational risk.

States Assert Authority over Small Lenders

States from California to Maryland have enacted anti-broker clauses in an attempt to prevent local lenders from partnering with banks to evade state consumer protections. In court litigation to date, none of these state anti-broker laws have been overturned. States with anti-broker provisions include California (effective in late 2004), Colorado, Indiana, Louisiana, Oklahoma, Virginia, Georgia, Maryland, Montana, and Massachusetts. Florida regulators report that they consider rent-a-bank arrangements a violation of their regulatory program. Federal courts in New York, Florida, Maryland, Colorado, North Carolina and Georgia have denied bank/payday lender claims to total preemption of state law and have remanded payday loan cases to state court, most recently in New York.

State regulators that have been and are currently actively fighting the rent-a-bank evasion of state small loan and usury laws include the New York Attorney General who is suing County Bank of Rehoboth Beach, DE and two of its loan-by-phone servicing companies; the North Carolina Attorney General and Banking Commissioner, who opened an investigation into Advance America's lending practices; and the Georgia Attorney General's office, which is in federal court to defend Georgia's new anti-rent-a-bank state law. Other states involved in regulatory action to prevent rent-a-bank payday lending include Ohio, Colorado, Oklahoma and Virginia.

FDIC Guidelines Protect Lenders, Not Borrowers

FDIC payday loan guidelines are no substitute for state usury and small loan laws and do not regulate loans made in partnerships between banks and third-parties. The FDIC guidelines do not cap fees for payday loans, set loan size or term limits, or prevent perpetual debt. FDIC subprime capitalization requirements have little impact on banks that immediately sell 85 percent or more of loans back to their payday loan partners. Most importantly, the FDIC failed to mandate that its insured banks assess ability to repay these loans, a decidedly unsafe and unsound practice. Moreover, the FDIC has not vigorously enforced its guidelines, encouraging additional state banks to enter the rent-a-bank business.

We applaud the Federal Reserve for choosing not to follow the FDIC's approach to permissive regulatory treatment of banks in the payday loan business.

Recommendations

We urge Congress to clarify that bank charters are not for rent and to insist that the FDIC take action against state banks involved in payday lending by prohibiting federally insured banks from directly or indirectly making payday loans. We believe that Congress never intended for state chartered, federally insured banks to be empowered to rent their interest rate exportation powers to third party entities to make predatory loans. Rent-a-bank payday lending undercuts state authority to enforce usury laws, small loan regulations, and even state payday loan laws. We urge you to take immediate action to stop this practice.

We also urge Congress to stop lending that entices consumers to write checks without money in the bank, by prohibiting the use of checks drawn on federally-insured depository institutions as the basis for loans. Bills have been filed in prior sessions of Congress to accomplish this reform.

B. Truth in Lending Should Apply to Bank "Overdraft" Bounced Check Loans

The Federal Reserve Board recently announced new, proposed rules to cover overdraft extensions of credit under the Truth in Savings Act, Reg DD, instead of under the Truth in Lending Act. [10] That is a completely inadequate response to the real need consumers have for information about the exorbitant costs of these loan products. Congress should step in and require – at the least – that bounce loans be treated just as all other extensions of credit are treated under the federal Truth in Lending Act. This equivalent treatment would simply – and most importantly – require that creditors of bounce loans *inform* consumers about the true costs of this credit.

Bounce "protection" loans[11] are a new form of overdraft protection that some banks are using to boost their non-interest revenue.[12] It is a systematic attempt to induce consumers into using overdrafts as a form of high-cost credit not only with checks, but using ATMs, debit cards and other methods. These plans offer short-term credit at triple-digit rates. Bounce loans are an extraordinarily expensive credit product. For example, a $100 overdraft will incur at least a $20 fee. If the consumer pays the overdraft back in 30 days, the APR is 243 percent. If the consumer pays the overdraft back in 14 days, which is probably more typical for a wage earner, the APR is 520 percent. Bounce loan fees can be triggered for overdrafts of a few dollars (especially for debit card point-of-sale overdrafts), making the APR even more astronomical. And once a consumer triggers an overdraft, it can start a chain reaction of fees as further overdrafts occur by means of checks, ATM transactions, debit card transactions, automatic payments, and other methods.

Bounce loans made by ATM and debit cards are especially unfair because consumers don't expect to overdraw using these devices. The banks' claim that bounce loans save consumers merchant returned check and other fees does not apply, since no check has been

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[10] Comments of the National Consumer Law Center, Consumer Federation of America, Consumers Union, National Association of Consumer Advocates, and Woodstock Institute to the Federal Reserve System, 12 CFR Part 230, Docket No. R-1197, "Proposed Amendments to Regulation DD and Proposed Overdraft Protection Guidance," August 6, 2004, available at www.consumerfed.org/

[11] Bounce "protection" is a euphemism used by banks to describe this high-cost credit product and is used to distinguish this non-contractual product from tradition overdraft protection.

[12] For more information on bounce credit, see Consumer Federation of America & National Consumer Law Center, *Bounce Protection: How Banks Turn Rubber Into Gold By Enticing Consumers to Write Bad Checks* (2003), available at www.consumerlaw.org/initiatives/test_and_comm/appendix.shtml.

written and a withdrawal or purchase can simply be denied for lack of funds. There is no purpose in allowing overdrafts by ATM and debit card except to provide payday loans and high-priced credit cards.

When a consumer uses bounce credit, the bank deducts the amount covered by the plan plus the fee by setting off the consumer's next deposit, even where that deposit is protected income, such as a welfare or Social Security check. The fee is often the same amount charged for an NSF fee on a returned check, typically $20 to $35 per overdraft, and in some cases the bank also charges an additional, $2 to $5 per-day fee. All of the federal banking regulators have recognized that this product is credit as defined by TILA.[13] Some state regulators have reached the same conclusion.[14]

According to the American Banker, nearly 3,000 banks now offer bounce protection.[15] A survey by the Woodstock Institute, included in comments filed with the Federal Reserve in August, found that seven of the largest banks in Chicago, which control over 50 percent of the market share in that city, have instituted bounce loan programs.

Consumers Find Key Features of Bounce Loans Unfair

Recently, a survey poll of a representative sample of 1,000 adult Americans conducted for CFA by Opinion Research Corporation International (ORCI) asked consumers their opinion about two features of bounce loans. The survey asked consumers about their opinions on the fairness of: 1) permitting overdrafts without obtaining the consumer's affirmative consent; and 2) permitting customers to overdraw their accounts at automatic teller machines (ATMs) without providing the consumer with any notice or warning of the overdraft on the ATM screen or asking for consent to advance funds and impose a fee.

Well over twice as many consumers thought that banks permitting overdrafts without obtaining the consent of their customers was unfair (68 percent) rather than fair (29 percent). On the question of permitting overdrafts without any notice at the ATM, an overwhelming majority (82 percent) said that this practice was unfair, with 63 percent saying it was "very unfair." Only 17 percent said it was fair.

Vulnerable Consumers Are Most Affected

Bounce loan fees are mostly generated from a small minority of customers, who are among the most vulnerable of consumers. The ORCI poll asked consumers about their own experiences with overdrafts and found that 28 percent of consumers said they had bounced at least one check in the past year. Of these consumers, about two-thirds said they had bounced

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[13]Interagency Proposed Overdraft Protection Guidance, OCC Docket No. 04-14, OTS No. 2004-30, Federal Reserve System, Docket No. OP-1198, FDIC and NCUA

[14]Indiana Department of Financial Institutions, Newsletter – Winter 2002 Edition (Nov. 2002), at 2, Clearinghouse No. (D/E: Fill in number); Letter from Assistant Attorney General Paul Chessin, Colorado Department of Law, Consumer Credit Unit, Mar. 21, 2001 (in response to referral from the Administrator for the Colorado Uniform Consumer Credit Code).

[15] Laura K. Thompson, *Lending Rule Won't Apply to Overdrafts*, American Banker, May 28, 2004.

only one or two checks, while the remaining one-third said they had bounced at least three checks. In surveys, consumers typically underreport the frequency with which they bounce checks.

The CFA survey revealed that moderate-income consumers with household incomes of $25,000 to $50,000 (37 percent), those 25 to 44 years of age (36 percent), and African Americans (45 percent) were most likely to have overdrawn their accounts. Twenty-two percent of the lowest income group surveyed, making less than $25,000 a year, and less educated consumers (33 percent) reported that they do not have a bank account.

A third party vendor who promotes bounce loans has said that about 15 percent of customers incur bounce loan fees.[16] A study by the Washington State Department of Financial Institutions reveals over 20 percent of borrowers who incur bounce loan fees are charged such fees two or more times per month.[17] According to another bounce loan vendor, 4 percent of bounce loan customers are responsible for 50 percent of loan fees.[18]

Financial Institution Marketing of Bounce Loans

The Consumer Federation of America conducted a review of the websites of 50 financial institutions to assess the current state of advertising and disclosures of this product. The results show that, despite over a year and a half of controversy surrounding this loan product,[19] and the announcement of the proposed Interagency Guidance months before the survey, many financial institutions continue with "business as usual" for bounce loans.[20]

CFA's review examined both advertisements and the Policy/FAQ/ fine print sections of websites (hereinafter "Policy/FAQ disclosures"). Out of 50 websites, 41 of them contain advertisements for bounce loan programs, while 23 contained Policy/FAQ disclosures. Over one third (34 percent) of the advertisements contained language that encouraged customers to overdraw their accounts, using statements about "running short on cash between paydays" or "checking account running a little thin?" One advertisement even touted bounce loans as an "excellent alternative to expensive payday lending loan or check cashing outlets."

Many of the websites also made contradictory statements suggesting guaranteed coverage, using themes of "we've got you covered" or "peace of mind," while downplaying the "discretionary" aspects of the program that were disclosed. Over half (54 percent) of the advertisements promoted the guarantees of coverage more heavily than the discretionary nature.

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[16] Paul Gentile, *With Fed Electing Not to Treat Overdrafts as Loans, Door Wide Open for Continued Growth in CU Industry*, Credit Union Times, June 23, 2004 (quoting Bill Strunk of Strunk & Associates).
[17] Washington Department of Financial Institutions, *Overdraft Protection Programs* (September 19, 2003) at p. 4, available at http://www.dfi.wa.gov/Legislative percent20report.pdf
[18] Alex Berenson, *Some Banks Encourage Overdrafts, Reaping Profit*, New York Times, Jan. 22, 2003.
[19] Consumer Federation of America & National Consumer Law Center, Bounce Protection: How Banks Turn Rubber Into Gold By Enticing Consumers to Write Bad Checks (Jan. 27, 2003), available at www.consumerlaw.org/initiatives/test_and_comm/appendix.shtml.

The review of bounce loan advertisements and Policy/FAQ disclosures also found that institutions did not provide vital information about the requirements and terms of bounce loans. These omissions are especially problematic given there is no common understanding of how these programs operate that a reasonable consumer could be expected to know. For example, only 39 percent of the advertisements and only about a quarter (26 percent) of the Policy/FAQ disclosures revealed the specific dollar amount of the bounce loan/overdraft fee. Only 39 percent of both advertisements and disclosures informed the customer about the expected repayment schedule for bounce loans.

Truth in Lending Should Apply to Bounce Loans

Bounce credit fees clearly meet Regulation Z's definition of finance charge. Section 226.4(c)(3) of Regulation Z, which excludes fees for traditional overdrafts, provides that overdraft fees are finance charges when "the payment of such items and the imposition of the charge were previously agreed upon in writing." Although banks offering bounce credit have sought to avoid Regulation Z's coverage by claiming that the bank's payment of an overdraft in a "bounce protection" plan is "discretionary" and that such payments have not been agreed to in writing, these assertions are not supportable. First, bounce credit is not discretionary. These plans are administered through computer software and thus are formal, systematic programs rather than an occasional customer courtesy. Moreover, banks extend bounce credit pursuant to an agreement in writing, whether through advertisements, correspondence, or on a website. Consumer assent is not necessary, and consumers often are held accountable for fees unilaterally imposed by banks.

An APR disclosure and TILA coverage is critical for bounce loans. Without it, consumers have no way to compare the cost of other similar credit transactions, such as payday loans, pawnbroker loans, auto title loans, overdraft lines of credit, and credit card cash advances. Under the Board proposal, the disclosed APR for a typical payday loan is 391 to 443 percent[21] but for a bounce loan the lender may disclose under TISA that the account is actually earning interest! Without apples to apples comparisons, there is no competition to reduce the cost of any of these products.

Consumers do find APR disclosures useful. Several studies have found that an ever-increasing number of consumers know about and rely upon APR disclosures. The percentage of consumers aware of APRs increased from 27 percent in 1968 to over 80 percent in 2001.[22] The percentage of consumers that read TIL disclosures carefully increased from 27 percent in 1977 to nearly 50 percent in 2001.[23] Moreover, 60 percent of consumers surveyed in 2001 agreed that TILA disclosures are helpful.[24] Over two-thirds of consumers think that the APR is an important item of information about credit terms.[25]

[21] Keith Ernst, et al., *Quantifying the Economic Cost of Predatory Payday Lending*, Center for Responsible Lending (December 18, 2003), at 3.
[22] Thomas A. Durkin, *Consumers and Credit Disclosures: Credit Cards and Credit Insurance*, Fed. Res. Bull. 201, 207 (Apr. 2002).
[23] *Id.* at 208 (Table 9).
[24] *Id*.
[25] *Id*. at 203.

Abandoning the principles of TILA is particularly ill-advised in the case of bounce loans. If a loan product carries a low APR, such as 3 percent, consumers will not be significantly harmed by entering into a loan transaction unaware of the APR. Bounce loans, however, carry effective APRs in the triple digits. The Board's failure to require TILA disclosures for bounce loans means that consumers are likely to enter into these abusive, extraordinarily expensive transactions while unaware of their costs.

Further, by allowing bounce loans to be made without APR disclosures, the Board proposal misses an opportunity to increase rate competition in the segment of the consumer credit market where it is most desperately needed - the market for subprime small loans. The entry of bounce loan lenders into this market has the potential of creating more rate competition and placing downward pressure on the exorbitant rates consumers pay. However, if banks are allowed to offer bounce loan credit without making the disclosures that other lenders must make, consumers are deprived of the ability to compare bounce loans to other products. Without even-handed regulation of banks and other small loan lenders, the opportunity to enhance competition will be lost. Refusing to require APR disclosures for bounce loans means abandoning low-income consumers to the worst elements of the consumer credit market.

Application of TILA's substantive restrictions on credit cards will go a long way in addressing one of worst aspects of bounce loans – that consumers are extended these loans without their affirmative assent, and sometimes even without their knowledge that this product is attached to their accounts. TILA's special credit card provisions include: (i) a prohibition against the unsolicited issuance of credit cards[26] and (ii) a prohibition against set-off of a deposit account unless the consumer affirmatively consents separately in writing to either a security interest taken in the account or to an automatic payment plan.[27] These special credit card provisions apply whether or not a finance charge is imposed.

Instead of discouraging overdrafts and encouraging sound financial management, these banks are now encouraging consumers to use high-cost credit. By permitting overdrafts, not just through checks but ATMs and debit cards, a growing number of banks are creating new ways to impose exorbitant fees and create financial hardship. If the Federal Reserve fails to require financial institutions to comply with Truth In Lending's open-end credit rules, Congress should amend TILA to make it clear that all lenders must tell consumers the accurate cost of the money they borrow.

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[26] TILA, 15 U.S.C. § 1642; Regulation Z, 12 C.F.R. § 226.12(a); Official Staff Commentary § 226.12(a)(1)-2 (addition of overdraft privileges on a checking account with a check guarantee card constitutes issuance of a credit card). It is true that Regulation E governs issuance of an access device that permits overdraft credit extensions; however that provision applies when there is a *preexisting agreement* between a consumer and a financial institution to pay overdrafts. Reg. E, 12 C.F.R. 205.12(a)(ii). If the Board allows bounce loan fees to be exempted from finance charge treatment, it is essentially stating there is no pre-existing agreement. In that case, Regulation Z would govern issuance.

[27] TILA, 15 U.S.C. § 1666h, Regulation Z, 12 C.F.R. § 226.12(d); Official Staff Commentary § 226.12(d)(1)-3 (specifically applying rule against offsets to overdraft credit).

C. Refund Anticipation Loans secured by EITC benefits, tax refunds

Refund anticipation loans (RALs) are high cost loans secured by and repaid directly from the proceeds of a consumer's tax refund from the Internal Revenue Service (IRS). Because RALs only last about 10 days, fees for these loans translate into triple digit annualized interest rates. RALs drain billions from the pockets of consumers and the U.S. Treasury. They are targeted at the working poor who receive the Earned Income Tax Credit (EITC), a refundable credit provided through the tax system and intended to boost low-wage workers out of poverty. The EITC is the largest federal anti-poverty program, with over $36 billion provided to over 20 million families last year.[28]

Consumers paid an estimated $1.14 billion in RAL fees and an additional $406 million in "administrative" or electronic filing fees in 2002 to get quick cash for their refunds. RAL volume increased moderately from 2001 to 2002, with approximately 12.7 million RALs taken out during the 2002 tax-filing season, compared to 12.1 million in 2001.

The effective annualized interest rate for RALs based on a 10 day loan period ranges from about 70 percent (for a loan of $5,000) to over 700 percent (for a loan of $200), or 94 percent to 1837 percent if administrative or "e-filing" fees are included. Tax preparation chains and RAL lenders have been reporting lower Annual Percentage Rates (APRs) by "unbundling" charges from the loan fees. These APRs give a less accurate picture of the true "cost of credit" for RALs.

Over half of RAL consumers are recipients of the Earned Income Tax Credit (EITC), despite the fact that EITC recipients only constitute 15 percent of all taxpayers. RALs siphoned off an estimated $749 million in loan fees and administrative/electronic filing fees from low-wage workers who receive the EITC. If tax preparation fees are included, the total estimate rises to $1.59 billion paid by EITC recipients Check cashing fees for 45 percent of these EITC recipients add another $161 million, for a total estimate of $1.75 billion spent by the working poor to get less than two weeks quicker access to this government benefit distributed through the tax system.

The Internal Revenue Service (IRS) continues to tacitly promote RALs by providing the Debt Indicator, which uses taxpayer data to screen loan applicants for tax refund offsets. The IRS also continues to permit commercial tax preparers to market RALs and other paid products through the IRS Free File program.

The number of partnerships between tax preparers and high-cost fringe financial service providers has increased. In addition to check cashers, commercial preparation chains now partner with rent-to-own companies and purveyors of costly stored value cards.

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[28] National Taxpayer Advocate, *FY 2003 Annual Report to Congress*, December 31, 2003, at 27.

Recommendations to Protect Taxpayers from RAL abuses:

- Prohibit cross-lender debt collection in RALs, through which RAL bank partners repay past loans from current year tax refunds, acting as debt collectors for each other.
- Halt the IRS Debt Indicator, a service provided to RAL lenders by the IRS which checks for other claims on the taxpayer's tax refund and passes this taxpayer information on the to the bank involved in the RAL. This is information available to no other commercial entity.
- Enact a federal cap on RAL rates. Failing that, make RALs subject to state usury and small loan interest rate laws. Enforce any existing loan broker statutes against tax preparers who facilitate RALs.
- Prohibit tax preparers from referring consumers to commercial check cashers, rent-to-own stores, or other high-priced financial services.
- Require tax preparers to be licensed and have minimum qualifications. State and federal regulators should address whether car dealers, check cashers, and payday lenders engaged in tax preparation are doing so competently and correctly.
- Require RAL lenders and tax preparers to include all of the costs of a RAL in the Truth in Lending disclosures, including any "dummy" account, administrative, electronic filing, or document preparation fees. RAL lenders should be prohibited from disclosing misleading APRs by subtracting out or "unbundling" charges.
- The Department of Treasury can provide bank accounts for EITC recipients who file their taxes electronically in order to receive direct deposits of refunds without having to purchase a RAL. Bank partnerships with free tax assistance programs can provide free or low cost savings accounts that remain open all year.
- Rethink the Congressional 2007 deadline for achieving an 80 percent electronic filing rate, since achieving that goal is being borne by lower income taxpayers who pay for commercial tax preparation and RALs.

II. Restrict Deceptive and Abusive Credit Card Practices - Interest Rate "Bait and Switch"

Our organizations have commented at length elsewhere about the need for regulatory and legislative measures to curb abusive and deceptive lending practices by credit card issuers. As interest rates have dropped in the last few years, issuers have resorted to a number of questionable business practices to prop-up interest income and to boost fee income. We urge this subcommittee to take a comprehensive look at the many traps, tricks and "gotchas" that issuers use to unjustifiably pad their profits. These include:

- **Deceptive and abusive fee and interest rate practices**, such as: average late fees of $31 (according to CardWeb.com), even to those who might only be one day late with a payment; the ever-shrinking period of time between when issuers mail a bill and when payment is due; disproportionate penalty interest rates of 30 percent that apply retroactively to a consumer's balance; and "fixed" interest rates that can be changed with as little as 15 days notice.

- **Inadequate disclosure.** Some issuers continue to try and hide the real costs of credit. For example, a number of credit card companies have been repeatedly criticized for inadequately disclosing the fees and higher interest rates they charge consumers that they allow to exceed their credit limit. In another example, MBNA attempted in early 2003 to hide information on the total balance owed by their customers by moving this figure from a prominent location on the top of the bill, to the bottom. MBNA backtracked after being publicly criticized for this step. Issuers have also fought state and federal requirements for effective disclosure to consumers on their billing statements of the length of time it would take to pay off their balances and the minimum payment rate, and the total costs in interest and principal if they did so.

- **Mandatory arbitration**. Many credit card contracts contain pre-dispute mandatory arbitration as a requirement, to prevent consumers from exercising their legal rights in court.

- **Aggressive and deceptive marketing of credit insurance** and other product "add ons" of very little value.

- **Failure to pass along interest rate reductions**, through rate "floors" in credit card contracts and other means.

Perhaps the single most abusive of these traps involves increasing consumers' interest rates on existing balances based on a decline in their credit scores. Creditors call this practice "risk-based re-pricing." Consumer organizations call it "bait and switch." It has been the subject of a number of critical and high-profile articles in the *New York Times* and other leading media outlets recently.

Last year, for example, the *New York Times* reported that three-quarters of all card issuers have given themselves the right to abruptly increase interest rates to as high as 30 percent based on a decline in a credit score or minor delinquencies with another creditor, even if the consumer has made no late payments or missteps with the card in question.

This arbitrary, punitive and counter-productive practice must be banned. It is simply not a fair business practice to suddenly double an agreed-upon interest rate for consumers who are paying their bills on time. If creditors were truly concerned about their financial exposure to customers who are becoming increasingly risky, as they claim they are, they would move to cap consumers' credit limits, not jack up their interest rate on previous purchases. For consumers whose credit scores have dipped by just a few points, this is an unjustifiable violation of the financial terms to which creditor and consumer have previously agreed; an unscrupulous attempt to increase interest income at the consumers' expense. For consumers who might truly be in financial trouble (and are having significant trouble paying their other creditors) such a move is likely to increase their financial risk by requiring them to pay significant new charges. Moreover, as reported by the Consumer Federation of America in its study on credit scores in December of 2002[29], there are significant and unexplained credit score variations that occur between credit bureaus for the same consumers. There are still too many questions about the

[29] http://www.consumerfed.org/121702CFA_NCRA_Credit_Score_Report_Final.pdf

accuracy and completeness of credit scores for creditors to be using them as the basis of such a significant change in terms.

III. Proliferation of Plastic, Lagging Protections

Individuals are increasingly being asked to accept stored value cards to receive payments of funds that are essential for day to day family expenses. These cards should offer the same level of consumer protections as those bank debit cards that are linked to individual consumer checking accounts. These cards, sometimes called stored value cards, are increasingly targeted to those not using traditional deposit accounts. Stored value cards include payroll cards, prepaid cards sold to individuals for Internet and in-person card use, cards used to deliver income tax refund monies or income tax refund loan proceeds, child-support cards, and cards used to draw unemployment payments.

Payroll cards, one form of stored value card, are increasingly offered to low- and moderate-wage workers. These products are being marketed to workers as serving the same functions as a bank account even though present law is at best unclear about whether these cards carry the same federal consumer protections that apply to bank debit cards linked to an individual deposit account.[30]

A recent publication of the Federal Reserve Board highlights the risk for consumers of stored value cards in the absence of EFTA consumer protections. In the Winter 2004 Bulletin, an article by Federal Reserve staffers states:

> Products Not Related to Bank Accounts
>
> Electronic products that are not tied to a consumer bank account but instead store monetary value in a related database or on a card include prepaid cards (such as phone and gift cards), payroll cards, college and military cards, cards used to deliver insurance benefits to disaster victims, and cards used by states to deliver child support payments. These cards can look much like traditional debit cards (for example, they may carry a MasterCard or Visa logo) and may even be called debit cards by merchants and vendors.

The article continues, in a box titled: "E-Banking and Consumer Protection":

> …Generally, electronic fund transfer products not associated with a consumer bank account, such as stored-value cards, are not covered by the EFTA.[31]

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[30] For information discussing the issues and risks of payroll cards for employees and employers, as well as the ways in which these products could be enhanced to build a stronger bridge to financial security and fuller access to the banking system for unbanked workers, See:
http://www.consumersunion.org/pub/core_financial_services/000920.html, March 16, 2004 and
http://www.consumersunion.org/pub/core_financial_services/000922.html, March 16, 2004. A key issue highlighted in that material is the potential for a higher level of risk of loss or theft of funds accessible through the card than is present for consumers who hold a debit card linked to a traditional, individual bank account.

[31] *U.S. Consumers and Electronic Banking, 1995-2003*, Federal Reserve Bulletin, Winter 2004, pp. 3-4.

To make payroll cards and similar stored value cards a valuable stepping stone into the banking system, rather than an inferior product, we have called on the Federal Reserve Board to ensure that these cards have at least the same protections that apply to ordinary debit cards and to clarify that federal Regulation E fully applies to stored value cards, including payroll cards, regardless of whether the funds are held in an individual or a pooled account, and regardless of how the accounting is performed for these cards.

A payroll card looks like a bank debit card, but it can be linked to an account held in the name of the employer, with or without individual sub-accounting by the issuer. The employer's bank may transfer the payroll funds for all employees using the cards into a single account, and all the payroll cards for that employer may pull funds from that one account. It is also possible to set up the cards with individual accounts for each employee. When an individual account structure is not used, there are questions about the application of federal Regulation E. The OCC has identified Regulation E coverage as a key unsettled issue, stating in a May 2004 advisory letter to national banks: "There are a number of unsettled regulatory issues involving payroll cards including … whether Regulation E applies to payroll card systems…."[32]

We have asked the Federal Reserve Board to issue an interpretation determining that all payroll card programs and similar stored value card programs - including card programs using a pooled account in which funds paid by, on behalf of, or for payment to, a number of individuals - qualify as a "consumer asset account" under Regulation E and therefore that cardholders are entitled to the protections of the federal Electronic Fund Transfer Act, including liability limits and error resolution rights, such as the right to a ten business day recredit of funds removed in a disputed transaction.

Lower wage workers who are paid by payroll card, single-parent households receiving child support payments distributed by stored value card, and persons receiving unemployment payments through a state benefits card are the very households who can least afford to be deprived of funds, or delayed access to funds, due to a theft or an unauthorized transaction using the consumer's card. These funds are needed to pay rent or a mortgage, buy food, and pay bills. As the OCC told national banks earlier this year about payroll cards: "The systems hold what are, for the individual consumers, important amounts of money – their payroll." OCC Advisory Letter AL 2004-06.

A delay in access to funds or a loss of funds due to non-application of the protections of the Electronic Fund Transfer Act could trigger eviction, a black mark on a credit record, and hungry children. Lower income families simply do not have the assets to cushion against even a temporary interruption of funds. In the year 2000, significant numbers of U.S. households had negative or zero net worth, including 27.6 percent of Hispanic households, 29.1 percent of Black households, and 11.3 percent of White Non-Hispanic households. An additional 6.7 percent; 7.3 percent; and 4.7 percent of these households respectively had net worth ranging from $1 to

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[32] OCC Advisory Letter AL 2004-06, May 6, 2004.

$4,999, even when including equity in the family car.[33] These families simply can't afford to be without access to their funds because of a problem with a payroll card, child support card, or unemployment benefits card.

These cards are a growing business. Payroll cards are being actively marketed to employers as a way to reduce the costs of handling paper checks for employers and as a way to serve the needs of the millions of U.S. households who do not currently have bank accounts. A study issued by the Office of Comptroller of the Currency reported that 10 percent of unbanked households, representing 1 million families, were using payroll cards at the end of 2002.[34] Usage has grown dramatically since then. In May 2004, the Associated Press reported that 1,000 companies were using payroll cards in the U.S., distributing $11 billion annually in payroll and $4 billion annually in employee incentive or commission payments.[35] In that same story, a VISA spokesperson claimed "triple digit growth rates for this category." AP cites the Mercator Advisory Group for an estimate that the potential U.S. market for payroll cards for unbanked, temporary, and remote location workers is $109.8 billion.

Now is the time for the Federal Reserve Board or Congress to act to prevent payroll cards and other stored value cards delivering funds to families from becoming another inferior, "second-tier" product for persons lacking a bank account. We believe that the Federal Reserve Board has the power to interpret the requirement in Regulation E of a "consumer asset account" as satisfied by a pooled account holding funds upon which cardholding consumers are entitled to draw. Such an account holds assets owed to consumers even if it is not held in the name of the individual consumer. Without such an interpretation, unbanked consumers are offered a significantly inferior product and face significantly higher risks when they accept a payroll card, child support card, or similar stored value card—an electronic payment mechanism that lacks the baseline consumer protections available to other debit-based electronic payment mechanisms, that is, the protections of the Electronic Fund Transfer Act (EFTA).

The FDIC has taken an initial step in response to this significantly expanding market by addressing an issue within its jurisdiction – deposit insurance for stored value cards. The OCC has warned national banks that there are significant unsettled issues, including the application of the EFTA. The next step is up to the Federal Reserve Board. The Federal Reserve Board should interpret Regulation E so that the consumer protections of the Electronic Fund Transfer Act apply to the expanding market of stored value cards, particularly payroll cards, prepaid debit cards, child support cards, unemployment cards, and cards used to distribute employee benefits.

Payroll cards and other forms of stored value cards offer the promise of bringing persons not using traditional banking products into the electronic payments mainstream, but that promise cannot be fulfilled if these cards have absent, ambiguous or inferior consumer rights and protections. These plastic payment cards can also be exceptionally expensive. For example, the

[33] B. Robles, *Economic Opportunity: Family Assets*, June 2003, a report prepared for the Annie E. Casey Foundation, www.utexas.edu/lbj/faculty/robles/research.
[34] *Payroll Cards: An Innovative Product for Reaching the Unbanked and Underbanked*, OCC Community Development, October 2003.
[35] *New Payroll Cards Sub for Paychecks*, Associated Press Online, May 31, 2004.

fees for the new "Usher Raymond IV Debit MasterCard" include $3.95 for each additional "value load", $2.00 Cash Withdrawal Fee, $1.50 for each Balance Inquiry, a $4.95 Monthly Maintenance Fee, a $15 Card Activation Fee and $9.95 to replace a lost card. Every time the Usher card is used to purchase something costs one dollar. Shipping and handling adds $3.95. If you overdraw the card balance, a $5 fee will be assessed for each transaction that exceeds available funds. To speak to a live person about a problem with your account costs $1.50 a minute. And if you want the balance on the card transferred to you by check, a Balance Reimbursement Fee of $9.95 is deducted.[36]

Regardless of whether the Federal Reserve expands Reg E to cover some forms of stored value cards or the FDIC applies deposit insurance to pooled payroll card accounts, Congress should take action to expand protections consumers take for granted for debit and credit cards to apply to emerging payment products. The model Stored Value Card Act, drafted by the National Consumer Law Center, is the place to start.

IV. Other Credit Issues Impacting Consumers

A. Protect Consumers from unfair, deceptive and over-reaching Debt Collectors

There are a number of formal and informal legislative proposals floating around this Congress that would seriously undermine the consumer protections of the Fair Debt Collection Practices Act. This would be a mistake, especially without comprehensive hearings to consider all sides of the complicated questions facing consumers in the debt collection process.

The FDCPA does nothing to prevent the collection of a valid debt. It only prohibits debt collectors from inappropriate activities in the collection of those debts. The law establishes general standards of proscribed conduct, defines and restricts abusive collection acts, and provides specific rights for consumers. Collectors cannot harass consumers or invade their privacy, make false or deceptive representations, or use abusive collection tactics. Specific acts that are prohibited include late night or repetitive phone calls and false threats of legal action.

Studies have shown overwhelmingly that consumers generally fall behind on their debts because of a serious illness, a death in the family, or the loss of a job. Very few consumers deliberately avoid their debts when they have the ability to pay them. The recent recession cost millions of Americans their jobs, resulting in more consumers struggling to pay their bills. It is especially essential that the basic consumer protections in the FDCPA not be undermined.

In this testimony we address two anti-consumer proposals on debt collection. One is H.R. 3066, the other is a proposal to exempt check diversion companies from coverage of the FDCPA.

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[36] www.ushermc.com/faz/faz/html, visited 8/16/04. Cardweb.com/cardtrack/news/2004/July/30a.html stated "R&B artist Usher Raymond IV has given his blessing to a new MasterCard targeted at unbanked Americans."

H.R. 3066 would hurt consumers. This legislation would significantly reduce consumer protections in seven important areas:

Section 2. This provision would make much of the FDCPA inapplicable to legal pleadings. The collectors claim this is necessary to protect them from compliance with conflicting laws, so that they will not be required to include the notice of the right validate a debt (required by 15 U.S.C. § 1692g(a)) on legal pleadings. The collectors neglect to mention, however, that there have been no lawsuits on this point. More importantly, the amendment goes far beyond simply deleting the requirement for the validation notice on pleadings. It would immunize collectors who violate other important provisions of the FDCPA in formal pleadings, such as when they sue for more than is actually owed by the consumer; or obtain default judgments even after settling the case with the consumer. Moreover, this provision would do away with the informal debt validation procedure if the debt collector initiates contact by filing suit. This will force consumers to raise disputes in court when they could have been settled informally. Yet many consumers who are unable to represent themselves in court will find themselves subject to garnishments and seizures of assets for debts they never owed.

Section 3. This section would codify a verbose and difficult to read validation notice instead of a notice that simply tells consumers that they have a right to require the collector to verify a disputed debt. The notice proposed in Section 3 is used frequently in current collection letters, and is far from a model of simple language that Congress should endorse for a consumer notice. The proposed notice requires consumer education efforts that could be easily avoided by the use of simpler words and sentence structure.

Section 4. This section would add a statement in the statute's debt validation provision that a debt collector may engage in collection activities during the 30-day period that a consumer may request the debt to be verified by the collector. Since that is already allowed by both existing case law and an FTC formal advisory opinion, this amendment can only be viewed as an attempt to reduce the current law's requirements that the notice of the debt validation right not be rendered ineffective by debt collection threats that are either confusing or overshadow the notice of validation rights. Unless its intent is clarified, this amendment will simply stimulate litigation about its meaning. If it is intended to sanction efforts to obscure the debt validation right, it will diminish an essential consumer tool designed to avoid mistaken collection efforts that waste the time of consumers and collectors alike.

Section 5. Currently, two provisions of the FDCPA shield represented consumers from duns as long as the collector knows of their legal representation and the consumer's lawyer responds to collectors within a "reasonable" time. (15 U.S.C. §§ 1692b(6), 1692c(a)(2)). Section 5 of the bill would shield only a consumer represented by an "attorney at law" and replace the reasonable time requirement with a 30-day requirement. These amendments seem to be targeted at preventing the attorney's employees from preparing responses to debt collector inquiries, creating unnecessary drain on consumer attorney resources.

Section 6. The FDCPA currently requires a debt collector to stop requesting payments from the consumer once the consumer tells the debt collector to stop contact. Current law then permits the collector to notify the consumer only that the collector is terminating its collections, to explain the collector's ordinary remedies, or to state that the collector's remedy will be pursued. The existing protection gives consumers a respite from dunning calls and letters, without preventing the communication of real consequences which consumers need to know. However, Section 6 of this bill would restrict the debt collector to one notice to the consumer even if they are pursuing multiple remedies at different points in time. It's difficult to understand what interest is served by this proposal.

Sections 7 and 8. These sections would amend the FDCPA to require that the consumer send a written statement disputing the debt before the debt collector would have to pay attention to the dispute. These amendments would make it legal for a debt collector to actually ignore the consumer's telephone statements contesting the validity of the debt, requiring consumer disputes to be raised in writing before they will be considered by debt collectors. The collector would be permitted to presume the debt is valid even if it is disputed orally. The collector could threaten to report an orally disputed debt to a credit reporting agency as if it was uncontested. Collectors would be entitled to threaten the consumer: "I don't care what you say about fraud, having paid the debt, or identity theft; if you don't put a check in the mail today, we will ruin your credit." It's difficult to believe that this amendment has been introduced in a Congress that has repeatedly expressed its strong concern with the increasing crime of identity theft and telephone frauds!

Millions of American consumers would be considerably harmed if this misguided bill were to become law. H.R. 3066 weakens the substantive and procedural protections of the FDCPA.

We also urge you to resist the efforts of check diversion companies to obtain an exemption from the Fair Debt Collections Practices Act ("FDCPA."). If this exemption is granted, hundreds of thousands of innocent American consumers will pay unnecessary and unauthorized charges to these for-profit companies in response to deceptive threats to criminally prosecute them for writing bounced checks.

Check diversion companies are debt collectors which enter into contracts with District Attorneys to collect bounced checks for local merchants. These companies send letters on the DA's letterhead threatening criminal prosecution if the consumer does not attend a "financial responsibility" class, and pay high extra fees for these classes. Many consumers have been deceived by these companies into believing that if they did not pay these extra fees they would be criminally prosecuted, even when no prosecutor had ever determined that a crime had been committed, and the local prosecutor would never actually prosecute.

FDCPA does not stop or inhibit the legal activities of check diversion companies. In fact, most collectors of bounced checks operate fruitful businesses while fully complying with the FDCPA. However, check diversion companies are so profitable that they share their income with the DA's office, providing funds to this government office rather receiving money from it to perform a governmental function. Yet, in these check diversion programs the DAs have not done any investigation to determine the critical requirement of the crime – an intent to defraud. Indeed most of these consumers have not intended to defraud, and quickly pay off the checks upon receiving notice. As a result, many consumers who have inadvertently bounced small checks are deceived into paying as much as $140 extra to avoid a criminal prosecution which would never occur if the DA were actually handling the case. Indeed, regardless of the involvement of the for-profit check diversion program, the majority of bounced check cases are not criminally prosecuted because there is no intent to defraud, a required element of the crime.

The FDCPA only limits the activities of check diversion companies in its requirements that no deception be committed, that consumers be advised of their right to request validation of the debt, and that only authorized fees be collected. These are requirements that all debt collectors collecting bounced checks are able to comply with and still successfully collect. Specifically, check diversion companies have consistently been found liable by the courts, or have settled cases alleging three types of illegal conduct:

- **Deceptive Behavior.** The check diversion companies' letters to consumers were deceptive because they looked like they actually came from the District Attorney and implied that the DA had determined the consumer had committed a crime. In fact no DA ever reviews cases before the letter threatening criminal prosecution is mailed. In many situations, if the DA had reviewed the case, no intent to defraud would have been found, and no criminal prosecution would have been threatened.

- **Failure to Provide Notice of the Right To Verify the Debt.** Unlike all other private debt collectors collecting debts, including bounced checks, the check diversion companies refuse to provide notice to consumers that they have the right to request verification of the debt. In many situations this right would allow consumers to explain that they have already paid off the check, or do not believe they owe it.

- **Attempted Collection of Illegal Fees.** Generally, state laws specifically provide the extra fees that consumers owe when they write a check that bounces. Often the courts can impose monetary penalties after a conviction for writing a bounced check (which must include a finding of intent to defraud). Yet the check diversion programs insist upon the payment of these fees even when no court has found – or would find – the consumer guilty of bouncing a check. For consumers, this often turns a mistake of a $10 or $20 bounced check into a cost approaching $200.

The majority of District Attorneys in the nation do not use check diversion companies, finding alternative, far less abusive, ways to enforce laws against writing checks that bounce for insufficient funds. Many DAs use dispute settlement programs to resolve bounced check issues between merchants and consumers. Other DAs simply write their own letters explaining the process to consumers. These letters do not require the payment of the exorbitant additional fees charged by the check diversion companies, they simply advise of the process involved when a payee of a check that has bounced brings the case to the criminal court. These DAs find that even without employing private companies which make millions of dollars in profit from consumers who have inadvertently bounced a check, only a very few cases are criminally prosecuted.

Check diversion companies do not need an exemption from the FDCPA. They can operate profitable, effective businesses without this exemption, simply by complying with the law. This would only mean that 1) the check diversion company not imply that the DA has reviewed the consumer's case and found that a crime has been committed, unless the DA has done so; 2) the letter to the consumer includes the required notice of the consumer's right to request validation of the debt; and 3) the company only collect fees that can be legally charged.

The Fair Debt Collection Practices Act does not inhibit the collection of debts; it only prohibits deception and abuse, and requires that consumers be allowed an opportunity to show they do not owe the debt. These requirements are appropriate and necessary for private individuals who are collecting debts – whether they are acting for private creditors or government officials. As Congress determined when passing the FDCPA, once the incentive of profit is injected into the collection effort, more protections are required.

We urge you to resist the effort of one small part of the collection industry to evade compliance with the Fair Debt Collection Practices Act. Bounced checks can be collected quite effectively by collectors complying with this important consumer protection law.

B. Make the EGRPRA process fair to consumers

Currently all of the federal supervisory agencies are jointly engaged in the process of reviewing laws and regulations affecting depository institutions to determine updates and necessary changes pursuant to the Economic Growth and Paperwork Reduction Act of 1996.[38] We are very concerned that this process will yield results that inappropriately favor industry over consumers.

A fair review cannot be limited to issues that favor those institutions. A full and fair analysis of appropriate updates for the regulations and laws must include proposals to benefit consumers. The Economic Growth and Paperwork Reduction Act simply requires the regulatory agencies to review regulations and laws:

> "...in order to identify outdated or otherwise unnecessary regulatory requirements imposed on insured depository institutions."[39]

To date, all of the written materials accompanying the request for comments regarding the rules display the agencies' unfortunate bias towards evaluating regulations and federal statutes *only* from the perspective of the financial institutions. Every single one of the questions posed to the participants in the focus groups to discuss this review reveals this skewed evaluation. To be fair, and to accomplish the overall goal of EGRPRA, and of underlying purposes of the regulations, the agencies must broaden their perspective, and include a full evaluation of *the impact on consumers* of all proposed changes.

We have filed extensive comments with the agencies regarding the consumer positions in the EGRPRA process.[40] We ask that the House Subcommittee instruct the agencies to ensure that their recommendations will be fair and protective of consumers.

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[38] 12 U.S.C. § 3311.
[39] 12 U.S.C. § 3311(a).

C. Stop the OCC From Preempting State Laws

Important unfinished business by the Committee includes the need for action to curb the sweeping preemption rules adopted by the Office of the Comptroller of the Currency (OCC). These regulations have the effect of over-riding state consumer protection laws that formerly applied to national banks and their state-licensed non-bank operating subsidiaries. We praise Chairwoman Kelly and her Subcommittee on Oversight and Investigations for holding hearings earlier this year that raised profound questions about the legitimacy of the OCC's actions and whether the new rules correctly interpreted Congressional intent. Reps. Gutierrez and Paul and 28 original co-sponsors subsequently introduced Congressional motions of disapproval, H.R. 4236 and 4237, intended to overturn the OCC's over-reaching rules. We and other consumer and community organizations have written committee members voicing support for consideration of these resolutions. Unfortunately, the full Committee has not scheduled mark-ups on them. We strongly urge that such actions be taken before the close of the Congressional session.

D. Rent To Own Abuses

Rent-to-own is another credit transaction pretending to be something else to avoid consumer protections. These are essentially appliance and furniture retailers, which arrange lease agreements instead of the typical installment sales contracts for customers who cannot purchase goods with cash or who are unsophisticated about money management. The lease agreements are short term so that "rental payments" are due weekly or monthly and contain purchase options that typically enable consumers to obtain title to the goods by making an additional payment at the end of a stated period, such as eighteen months. The leases are "at will," and theoretically need not be renewed at the end of each weekly or monthly term.

Marketing of rent-to-own is targeted at low-income consumers by advertising in minority media, on buses, and in public housing projects. FTC statistics show that the RTO customer base is among the poorest, and that the vast majority of their customers enter into these transactions with the expectation of buying an appliance and are seldom interested in the rental aspect of the contract. RTO dealers emphasize the purchase option in their marketing while minimizing its importance in the written contract.

The chief problems with RTO contracts are that these supposed leases are used to mask installment sales, and that these sales are made at astronomic, and undisclosed, annual percentage rates. Under most RTO contracts, the customer will pay between $1,000 and $2,400 for a TV, stereo, or other major appliance worth as little as $200 retail, if used, and seldom more than $600 retail, if new. This means that a low-income RTO customer may pay one and a half to twelve times what a cash customer would pay in a traditional retail store for the same merchandise.

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[40] http://www.federalreserve.gov/SECRS/2004/April/20040427/R-1180/R-1180_462_1.pdf

We oppose H.R. 996, the Consumer Rental-Purchase Agreement Act of 2003, which pretends to protect consumers but does no such thing. Instead, the bill preempts the state laws providing the strongest protection for consumers, including state laws of Wisconsin, Michigan, Minnesota, Vermont, North Carolina, and New Jersey. We continue to urge Congress not to overturn state laws that prevent predatory financial practices. A cursory reading of the bill might lead one to believe that some of the provisions would actually help consumers, but a close evaluation reveals that there are no meaningful protections whatsoever in this bill. Even the one provision that comes closest to requiring some helpful information to consumers (Section 1010) has such weak penalties attached that dealers will have no incentive to comply.

Year after year the rent-to-own industry brings legislation to Congress that pretends to protect consumers but in fact merely seeks to preempt stronger state legislation. We urge you to oppose H.R. 996 and to send a strong message to the industry that you will not weaken protections for the poorest and least credit-savvy consumers.

E. Simplify Rules as Check 21 is Implemented

Payment methods are increasingly converging, but the consumer rights available differ vastly depending on how the payment was processed. A consumer who pays by debit card, for example, has the protections of the federal Electronic Fund Transfer Act, including a 10 business day right of re-credit of all disputed funds. The consumer never has to be without his or her funds for more than 10 business days when paying by electronic debit. When a consumer pays by check, however, the applicable consumer rights are much more murky. A paper check, or a check which is processed wholly electronically under bank-to-bank image exchange agreements, is subject to the Uniform Commercial Code and carries no baseline federal consumer protections.

Even though image exchange is an electronic processing method, the EFTA exemption for checks means that consumers don't get the crucial 10 day right of re-credit, and thus are at the mercy of their banks or the courts to win a return of disputed funds. Only when the consumer is provided a substitute check, the new Check 21 Act provides a 10 business day right of re-credit, but the Federal Reserve Board's narrow interpretation of the availability of this right in their regulations will restrict this right to those consumers who were provided with a physical substitute check, and not even require that banks provide that document on request. If, instead of image processing (no federal rights) or Check 21 processing (limited federal rights), the check is processed through lockbox conversion or point of sale conversion, it is covered by the EFTA (full federal rights).

When something goes wrong with a check payment, the consumer shouldn't have to sort out how that check was processed after it left the consumer's hands in order to learn his or her rights. Congress can take a significant step toward solving this mess by amending the EFTA to include all checks which are processed in whole or in part by the transmission of electronic information.

F. Update Jurisdiction Limits and Statutory Penalties of the Truth in Lending Act and the Consumer Leasing Act

TILA's jurisdictional limit for non-dwelling secured consumer credit transactions was set at $25,000 in 1968. That amount in today's dollars would be over $132,000.[41] The equivalent for the statutory damages amount of $1,000 in 1968 would be over $5,000 today. The numbers in the current statute need to be updated, and an inflation factor built in. The Consumer Leasing Act requires similar treatment.

Thank you for the opportunity to offer our comments.

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[41] *See* Consumer Price Index, Inflation Calculator, U.S. Department of Labor, Bureau of Labor Statistics, http://www.bls.gov/bls/inflation.htm.